Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area	CC Docket No. 96-149
and Policy and Rules Concerning the Interstate, Interexchange Marketplace	CC Docket No. 96-61

COMMENTS OF THE INDEPENDENT TELEPHONE AND TELECOMMUNICATIONS ALLIANCE

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SUMMARY

The Commission's decision to impose the *Fifth Report and Order's* separation requirements for mid-sized companies providing in-region, interstate and international exchange services is both ill-conceived and unfair. Not only do the separation requirements directly contravene Congressional intent as expressed in the Telecommunications Act of 1996, the Commission justifies its decision to apply these obsolete rules with theoretical speculation that themselves represent a fundamental misapprehension of the industry.

The result of the Commission's new rules is a local exchange market made less competitive owing to the disparate treatment of two classes of providers. On the one hand, the mid-sized companies are now hamstrung by regulations that hinder their ability to respond efficiently to rapidly evolving consumer demand. On the other hand, AT&T, MCI and Sprint, large companies whose vastly superior resources pose the greatest anti-competitive threat to the industry, do not have separate affiliate requirements for their offering of local services.

Indeed, 15 Members of Congress recently clarified that the absence of a separation requirement for the mid-sized companies in the 1996 Act was neither an oversight nor an invitation to the Commission to retain outmoded regulations that were adopted over a decade ago to deal with a far different regulatory and competitive market. Moreover, the Commission has based the need for these separation requirements on an esoteric industry model that inexplicably does not incorporate the actual practice of mid-sized companies in the local and long-distance markets. For example, although the Commission points to the threat of interconnection discrimination as one of the reasons that it chose to maintain the separation

requirements, all of mid-sized companies are dependent upon the services of nationwide facilities-based interexchange carriers to offer their interexchange services. Similarly, the Commission seems not to appreciate the status of mid-sized companies as resellers of bulk minutes, a fact explaining why these companies have no incentive to discriminate against interexchange carriers and hence why structural "solutions" like separation requirements are unnecessary. Finally, the Commission ignores existing regulatory mechanisms, such as the Part 64 accounting rules and state and federal regulation of access charges, that make continued separation requirements both redundant and costly.

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Pursuant to Section 1.429(f) of the Commission's rules, 47 C.F.R. § 1.429(f), the Independent Telephone & Telecommunications Alliance ("ITTA") hereby supports the relief requested by ALLTEL, USTA and Anchorage Telephone Utility in their petitions for reconsideration of the *Second Report & Order*[1] in the above captioned proceeding. ITTA urges the Commission to relieve mid-sized local exchange companies with less than two percent of the

[1] Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, *Second Report & Order*, CC Docket No. 96-149, and Policy and Rules Concerning the Interstate, Interexchange Marketplace, *Third Report & Order*, CC Docket No. 96-91 (April 18, 1997) ("*Second Report & Order*").

nation's access lines of the mandatory separation requirements to provide in-region, interstate and international interexchange services.

I. INTRODUCTION AND BACKGROUND

ITTA is a coalition of 15 independent, mid-sized telephone companies formed to represent the interests of mid-sized telephone companies as Congress defined them in the Telecommunications Act of 1996 ("the 1996 Act")[2]--those companies that serve less than two percent of the nation's access lines. The Commission, however, has stopped short of fully implementing the mandate and spirit of the 1996 Act and, relying on esoteric and impractical economic assumptions, retained the imposition of obsolete and unnecessary separation requirements upon mid-sized companies providing **in-region**, interstate and international interexchange services.

The Commission's decision to retain and make mandatory the *Fifth Report and Order's* separation requirements for mid-sized companies providing in-region, interstate and international exchange services is flawed for two separate, but interrelated, reasons. First, the separation requirements contravene Congressional intent and the de-regulatory impetus underlying the 1996 Act. During its consideration of that legislation, Congress had the opportunity to impose structural safeguards upon both the mid-sized companies and the Bell Companies. They chose to impose separation requirements upon the Bell Companies only. For the Commission now to continue imposing separation requirements on the mid-sized companies too, impermissibly substitutes Congress' judgment with its own.

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[2] Pub. L. No. 104-104, 110 Stat. 56 (1996).

Second, the 1996 Act's sweeping reform of telephone regulation and its concomitant introduction of vigorous competition has undermined the industry paradigm underlying the *Competitive Carrier Fifth Report and Order*--a paradigm the Commission has chosen not only to retain with respect to mid-sized company provision of in-region, interstate and international exchange services but even to expand, without recognizing that mid-sized companies do not typically own or operate their own facilities to provide interexchange services. Mid-sized companies primarily depend on resale as dominant means by which they provide interexchange services.[3] Together with the competitive market for services that the 1996 Act has already produced, the actual provision of interexchange services through the resale of other competing carrier's facilities more than suffices to ensure that these carriers cannot leverage their diminishing control over local facilities. Thus the maintenance of the separation requirements are not only redundant, they place the mid-sized companies at a competitive disadvantage compared to their much larger competitors.

II. THE COMMISSION'S REGULATORY TREATMENT OF MID -SIZED LECs DOES NOT REFLECT MARKET REALITIES.

Although finding that the mid-sized companies did not possess the market power necessary to engage in monopolistic practices and, on that basis, determining that it was unnecessary to regulate these companies as dominant carriers, the Commission nevertheless decided to maintain the separation requirements of the *Competitive Carrier Fifth Report and*

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[3] For example, although Citizens Communications has a limited interexchange network interconnecting some of its widely scattered local exchange service territories, Citizens is still dependent upon purchasing for resale interexchange services from a nationwide facilities-based network to provide its services.

Order.[4] As ALLTEL described,[5] the Commission theorized that because mid-sized companies control local exchange and exchange access facilities in small, geographically dispersed service territories, they possess the ability potentially to engage in three kinds of anti-competitive behavior: (1) to misallocate costs from their in-region, interexchange services to their monopoly local exchange and exchange access services within their local service region;[6] (2) to discriminate against the affiliate's interexchange competitors with respect to the provision of exchange and exchange access services;[7] and (3) to engage in "price squeezing" behavior by raising the price of access to all interexchange carriers thereby causing competing in-region carriers to suffer a comparative disadvantage.[8]

As a result of these findings, the Commission has continued to impose the following mandatory requirements on mid-sized companies offering interexchange services: (1) these services must be provided through a separate legal entity; (2) the mid-sized companies must maintain separate books of account for their in-region, long distance affiliate; (3) the mid-sized companies may not jointly own transmission or switching facilities with their long distance affiliate; and (4) the mid-sized companies must provide all tariffed services to their long distance affiliates at tariffed rates.

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[4] Policy and Rules Concerning Rates of Competitive Common Carrier Services and Facilities Authorizations Therefor, *Fifth Report and Order*, 98 FCC 2d 1991 (1984) (*Competitive Carrier Fifth Report and Order*) cited in *Second Report and Order* ¶ 160.

[5] *Petition for Reconsideration of ALLTEL Communications, Inc.*

[6] *Second Report and Order*, ¶ 159.

[7] *Second Report and Order*, ¶ 160.

[8] *Second Report and Order*, ¶ 161.

III. THE REQUIREMENT THAT THE MID-SIZED COMPANIES PROVIDE IN-REGION, INTERSTATE INTEREXCHANGE SERVICES THROUGH A SEPARATE AFFILIATE IS MISGUIDED AND COUNTER TO THE REQUIREMENTS UNDERLYING THE 1996 ACT.

A. THE SEPARATION REQUIREMENTS CONTRAVENE CONGRESSIONAL INTENT AND THE DE-REGULATORY NATURE OF THE 1996 ACT.

By retaining and strengthening separation requirements for the mid-sized companies, the Commission has not heeded Congress' mandate and has contravened Congressional intent as expressed in the 1996 Act. During the legislative process culminating with the passage of the 1996 Act, Congress, on numerous occasions, had the opportunity to impose structural safeguards upon all local exchange carriers—rural, mid-sized, and large LECs (including the Bell Companies). Not only did Congress refuse to impose separation requirements upon the mid-sized companies—identifying only the Bell Companies as the source of anti-competitive threats in this market[9]—it provided sunset provisions for the BOC structural separation rules, deciding that, even in the case of those providers, structural separation should be considered only a temporary measure.

Inexplicably in the face of this record, the effects of the Commission's decision is to go beyond the 1996 Act and "amend" the legislation by, in essence, recasting the scope of § 272 to include the mid-sized companies as well as the Bell Companies, albeit with a lesser degree of separation. Ironically, in their rules imposing separation requirements upon the mid-sized companies, the Commission does not provide these carriers with the advantage that Congress afforded the Bell Companies—the Commission adopted no sunset provision for the

[9] 47 U.S.C. § 272.

mid-sized companies in the *Second Report and Order*. This represents a complete inversion of the Congressional mandate for limited separation requirements.

The Commission's rules have also tipped the competitive balance against the mid-sized companies and in favor of the interexchange carriers. The three large interexchange carriers shortly will be offering local services on a geographic basis that will be considerably more extensive than that of even the largest mid-sized company. Unlike the mid-sized companies, however, AT&T, MCI and Sprint do not have separate affiliate requirements for their offering of local services, despite their preponderant long distance market share. Nowhere in the *Second Report and Order*, however, does the Commission attempt to justify this disparate treatment of these two providers of local services.

In the wake of the *Second Report and Order*, mid-sized companies face a competitive landscape in which they shoulder the heaviest regulatory burdens. Unlike the Bell Companies, the mid-sized companies' separate affiliate requirements do not sunset. Unlike the interexchange carriers, the mid-sized companies are forced to offer their services through separate affiliates. This is an untenable position for mid-sized companies. As the Congressional letter attached to Anchorage Telephone Utility's petition for reconsideration states, Congress chose not to impose a separate affiliate requirement on the mid-sized companies.[10] This recently restated Congressional intent underscores the Commission's departure from the spirit animating the 1996 Act and the Commission's failure to appreciate the unique market position of the mid-

[10] *See Petition for Reconsideration of Anchorage Telephone Utility* at Attachment A, *Letter to Honorable Reed E. Hundt, Chairman,* dated June 25, 1997, signed by Representatives Boucher, Tauzin et. al.

sized companies. In their letter, 15 Members of Congress, 14 Members from the committee of jurisdiction, confirm that Congress affirmatively decided against imposing separation requirements upon the independent local exchange companies and did so only with reluctance against the Bell Companies and only on account of the included sunset provisions.[11] The Representatives' letter also highlights the inherent unfairness of requiring the mid-sized companies to maintain separate entities for the provision of local and long distance services while permitting the far larger long distance companies to provide these services through the same entity. Faithfulness to the 1996 Act as well as fairness to the mid-sized companies requires the Commission to reexamine its decision to maintain the separation requirements for the mid-sized companies.

B. THE SEPARATION REQUIREMENTS IMPOSED IN THE SECOND REPORT AND ORDER ARE OBSOLETE.

The Commission's decision to continue to impose the separation requirements of the decade old *Competitive Carrier Fifth Report and Order* speaks volumes about the Commission's fundamental misunderstanding of the regulatory and competitive environment created by the 1996 Act. The industry model laying at the heart of the Commission's analysis of the local exchange market ignores the regulatory and competitive context within which interexchange services are now being offered. In addition to this deficiency in its theory, the *Second Report and Order* misunderstands how mid-sized companies actually offer their long distance services in practice.

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[11] *Id.* at p. 2.

While conjuring the specter of potential discrimination in the provision of interconnection services, the Commission downplays or ignores the three crucial factors that prohibit the mid-sized companies from leveraging their diminishing control over local facilities. First, nowhere in its theorizing about the ability of a mid-sized company to engage in interconnection discrimination against its long distance rivals does the Commission recognize that most mid-sized companies do not own and operate their own interexchange facilities. Because virtually none of ITTA's members own and operate such interexchange facilities and all ITTA's members depend almost entirely on resale, the Commission's analysis has no practical utility. Unfortunately for the mid sized companies, the Commission's sterile analysis is the basis for crafting unnecessary regulations with very real consequences.

Second, nowhere does the Commission acknowledge that because the mid-sized companies do not have their own nationwide facilities, they are resellers of bulk minutes and hence can not discriminate against an interexchange carrier without also discriminating against itself. This point is crucial for understanding why the structure of the industry itself provides a sufficient check upon anti-competitive behavior. A local exchange company reselling the long distance services of one of its rivals that discriminates on price or non-price terms against an interexchange carrier will adversely effect its own customers and, by definition, its profitability. Thus, regulation attempting to prevent such behavior is as irrational as it is unnecessary because no mid-sized company would cut off its nose to spite its face.

Moreover, as identified by ALLTEL,[12] interconnection agreements exist between mid-sized companies and IXCs that open for scrutiny the arrangements between LECs and IXCs. The 1996 Act established two mechanisms to ensure that LECs cannot engage in the type of discriminatory behavior identified by the Commission. Again, neither of these disincentives are discussed in the Commission's rules. First, the 1996 Act retains state and federal regulation of these markets. This regulatory layer includes the complaint process authorized by § 208 of the Communication Act of 1934, as amended, as well as the non-discrimination standards and switch conversion time frame provided by the *Equal Access Order*.[13] Second, most relationships between local access carriers and interexchange carriers are memorialized in interconnection agreements containing most favored nations (MFN) clauses. These clauses require the LECs to apply to all interexchange carriers the lowest negotiated rate between itself and any one of them. Thus, an independent LEC providing preferential terms to a single interexchange carrier will find itself altering the terms of its contracts with all of its carriers.

The Commission's fear that the mid-sized companies will misallocate their costs is similarly misplaced. As USTA's comments identified,[14] Part 64 of the Commission's rules contain detailed and comprehensive accounting requirements that eliminate the risk of cross subsidization between a LECs regulated and unregulated services.[15] The Commission's Part 64 rules already force the mid-sized companies to separate and allocate the cost of service between

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[12] *Petition for Reconsideration of ALLTEL Communications, Inc.* at p. 9.

[13] *MTS and WATS Market Structure Phase III*, Report and Order, 100 FCC 2d 860 (1985) (*Equal Access Order*).

[14] *Petition for Reconsideration, USTA* at pp. 5-7.

[15] 47 C.F.R., Part 64, Subpart I.

regulated and non-regulated activities. These rules were designed to deter improper allocations and heretofore have served that function well. The Commission's decision to apply still another layer of regulation to deter misallocation is redundant, unnecessary and costly.

The Commission's conclusion that a mid-sized company will be able to engage in a price squeeze is based on a wholly sterile economic model that ignores the already extant, and very real, regulatory and market forces that currently check such behavior. First, as USTA noted, the need of the rate of return companies to obtain regulatory approval before increasing access charges interposes a regulatory check upon the ability of the mid-sized companies to engage in price squeezing.[16] Although in the *Second Report and Order* the Commission recognized the existence of these regulatory bodies, it called into question, without analysis, their ability to deter price squeezing behavior.[17]

Price squeezing behavior is also highly unlikely because the 1996 Act itself has created a market based check on any price squeezing behavior. As a result of the 1996 Act, competitive LECs and interexchange carriers are able quickly to enter local markets and construct facilities with which to by-pass the local networks.

C. SEPARATE AFFILIATE REQUIREMENTS ARE NOT EVEN REQUIRED FOR SNET'S OFFERING OF INTEREXCHANGE SERVICES.

The inaccurate assumptions contained in the *Second Report and Order* about the nature and operations of the mid-sized companies are tellingly revealed by considering the

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[16] *Petition for Reconsideration, USTA* at pp. 5-7.

[17] *Second Report and Order* ¶¶ 111, 160.

specifics of just one of those companies, ITTA's largest member, Southern New England Telephone ("SNET"). Despite being the largest of the mid-sized companies, even SNET is a pure reseller of interstate interexchange services and is dependent upon a nationwide facilities-based interexchange carrier for its service offerings. Thus, the Commission's concerns about discriminatory treatment of competing interexchange carriers is wholly misplaced. SNET has interconnected with CLECs since 1995, well before the Congressional mandate for interconnection. There currently are 26 carriers certified to provide local service in Connecticut, including AT&T and MCI, and seven additional applications are pending before the Department of Public Utilities Control. Five of the CLECs have installed their own switches and four others have plans to install switches in the near future.

Absent the Commission's decision to interpose unnecessary regulations between the 1996 Act and mid-sized companies such as SNET, consumers in the region could be experiencing the same beneficial effects of competition in telephony that they currently are experiencing in video services. Just last week, for example, it was reported that in response to SNET's entrance into video services, Cablevision Systems has decided to upgrade its cable systems and increase services to Connecticut subscribers while maintaining prices.[18] Unfortunately, the Commission's separation rules ensure that the mid-sized companies such as SNET will be unnecessarily hamstrung in their provision of in-region, interstate and international exchange market.

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[18] *Communications Daily*, September 3, 1997.

IV. CONCLUSION

The Commission should eliminate the separation requirements found in the *Second Report and Order*. The Commission grounded these stringent and far reaching separation requirements on a theoretical analysis divorced from actual industry structure and practice. Not only do these requirements contravene the spirit and intent of the 1996 Act, they are unnecessary and redundant. As explained by NTCA,[19] the separation rules will only result in increased costs for the mid-sized companies at a time when their already narrow margins are being eroded by competing systems and providers, and the prospect of increasing Universal Service Fund contributions. Even more disturbing, the Commission's rules confer a competitive advantage to the companies that need it least--the large interexchange carriers. Unlike the mid-sized companies, the large carriers possess the competitive advantage afforded by being able to

[19] *Petition for Reconsideration, National Telephone Cooperative Association* ("NTCA"), p. 7.

offer local and long distance service as integrated companies. All other arguments aside, fundamental fairness provides a sufficient reason for the Commission to reconsider these rules as described herein.

Respectfully Submitted,

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September 8, 1997

Certificate of Service

I Andrea Rainey hereby certify that I have this 8th day of September, 1997 caused copies of the foregoing "Comments of the Independent Telephone And Telecommunications Alliance" to be served by hand on the following:

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